INTERNATIONAL ECONOMIC REVIEW

United States International Trade Commission
Office of Economics

Washington DC
20436

October 1994

In This Issue:

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UNITED STATES
INTERNATIONAL
TRADE COMMISSION

OFFICE OF ECONOMICS

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Summary of U.S. Economic Conditions

Mergers and Acquisitions

Merger and acquisition deals are sweeping the corporate sphere in such diverse sectors as telecommunications, defense, railroads, pharmaceuticals, retailing, health care, banking, and entertainment. The annual values of the announced mergers and acquisitions so far in 1994 amount to $210 billion, a rate which implies that annual values could reach the 1988 record of $336 billion. The 1994-announced big mergers include the Burlington Northern acquisition of Santa Fe Pacific ($2.7 billion), the Lockheed and Martin Marietta merger ($10 billion), LDDS Communications' acquisition of WilTel ($2.5 billion), Viacom's acquisition of Paramount ($10 billion), the Bank of America takeover of Continental Bank ($1.98 billion), and American Home Products' takeover of American Cyanamid ($9.7 billion).

Mergers and acquisitions are undertaken to gain market power, enhance efficiency, and maximize profits. History and business research suggest that these deals are only somewhat more likely to work as not. Acquisitions and mergers do not always lead to increased efficiency or greater profits or wealth for bidding firms. Although mergers frequently prompt a rise in the combined stock market value of the merging firms, these gains are often short-lived.

There have been five waves of mergers in the United States—in the 1890s, 1920s, 1960s, 1980s, and the wave currently taking place. The first four have differed in their success rates (e.g. the wave of conglomerate mergers in the 1960s, resulting in sprawling companies made up of often unrelated businesses, has been found particularly wanting). The present wave, the fifth, is uncertain as to results. The statistics on mergers and acquisitions show that a full one-third to one-half of such efforts over the last twenty years have not achieved their stated purposes and have resulted in break-ups, sell-offs, or other divestitures. According to S. N. Kaplan, finance professor at University of Chicago, 49 percent of acqusitions made between 1971 and 1983 were divested. The comparable share for the period 1983-90 is 30 percent.

As Cynthia Montgomery points out in this summer's *Journal of Economic Perspectives*, studies of mergers can single out three main perspectives of firms that merge or acquire competitors: the "market-power," the "agency," and the "resource" perspectives. The first two are consistent with profit maximization, and the third is consistent with the efficient allocation of resources.

The first view, associated with the work of Charles W.L. Hill and Corwin D. Edwards, argues that firms merge or acquire other firms to gain market power. The second, "agency" perspective is associated with the works of Dennis C. Mueller and also with other economists. And the third, "resource" view, is based on the work of Edith Penrose.

According to the "market-power" perspective, merging firms thrive at the expense of others not because they are any more efficient, but because they have access to conglomerate power. Conglomerates may yield power in an anticompetitive way by—(1) cross subsidization; (2) mutual forbearance; and (3) reciprocal buying.

The "market-power" perspective has its validity in the short run. Over time, however, monopolistic or oligopolistic positions become difficult to maintain because of rapid dissemination of technology, ease of entry, and influx of multinational business into markets where returns on capital are relatively high. All this tends to equalize profits in the long run and to reduce companies' dominance of the market.

The "agency" perspective proposes several reasons for acquisitions and or mergers: the pure pleasure of empire building, self-interested managers who pursue their own interests rather than acting as agents to carry out the interests of shareholders, and the dilution of shareholder power. The essence of this view is that managers hold little equity in the firm and therefore deploy corporate assets to benefit themselves rather than benefit shareholders. Self-interested managers might direct a firm's diversification in a way to increase the demand for their own services or

particular skills, i.e. "managerial entrenchment". Managers of firms with large cash flows and unused borrowing power are more likely to undertake low-benefit mergers. Mueller described this theory as "free cash flow":

> "Acquisitions are one way managers spend cash instead of paying it out to shareholders. Therefore, the [free cash flow] theory implies managers of firms with unused borrowing power and large free cash flows are more likely to undertake low-benefit or even value-destroying mergers. Diversification programs generally fit this category and the theory predicts they will generate lower total gains."

The "resource" perspective suggests that firms diversify in response to excess capacity in productive factors or resources. From this perspective, as long as expansion provides a way of more profitably employing underused resources, a firm has an incentive to expand. Further research, however, emphasizes that the specificity of the resources at a firm's disposal is an important factor in the profitability of mergers. More specific resources such as productive skills in biotechnology may only be applied to a small number of industries but may yield higher returns. In contrast, less specific factors can transfer easily but yield lower returns.

Evidence on profit maximization and mergers

A variety of studies in industrial organization have estimated the relationship between mergers and acquisitions and profit maximization using a host of industry variables: the degree of industrial concentration, industry growth rate, scale, and performance as measured by return on equity, return on invested capital, or the capital market value of the firm divided by the replacement value of its assets. These studies often found that firms' profitability decreased as diversification increased, that narrowly diversified firms built around more sophisticated assets earn higher levels of profits than do widely diversified firms, and that firms pursuing strategies of related diversification were on average more profitable than single line businesses. The evidence suggests that acquisitions were more likely followed by divestitures when targets were not in businesses highly related to those of the acquirer.

Perspectives of past mergers and acquisitions

An examination of mergers and acquisitions undertaken in the 1980s highlights the growing importance of leveraged buyouts and an increasing rate of divestiture over the decade. In 1980 the number of mergers and acquisitions reached 1,558, valued at $32.8 billion. Of this total, 104 or 6.7 percent were divested (sold by corporate owner to another party). Leveraged buyouts (the acquisition of a business in which buyers use mostly borrowed money to finance purchase price and incorporate debt into structure of business after change in ownership) numbered 11 deals valued at $236 million dollars. On the other hand, the 1994 announced major deals all involve firms in related industries.

Mergers and acquisitions peaked in number terms in 1986, reaching 4,463 deals valued at $206 billion. Of this total, 1,419 or 31.8 percent, valued at $72.4 billion were divested. Leveraged buyouts totaled 337 deals, valued at $45.2 billion. In 1988 takeovers totaled 4,233 deals, valued at $240.2 billion. Approximately 32 percent of these takeovers were divested. In 1990, takeovers totaled 4,168, valued at $172.3 billion, and 1,406 or 33.7 percent of those deals were divested. Leveraged buyouts in 1988 totaled 383 deals, and in 1990 leveraged buyouts totaled 254 deals (table 1.)

Distribution of mergers and acquisitions by industry in 1990 was skewed towards finance, insurance, and real estate, totaling 905 deals valued at $28.1 billion, followed by services totaling 744 deals valued at $32.8 billion. Mining takeovers totaled 208 deals valued at $11.6 billion. Manufacturing acquisitions and mergers totaled 1,386 deals valued at $67 billion. Takeovers in manufacturing were widely spread with the largest concentrations in industrial machinery, chemicals and allied products, electrical and electronic equipment, and printing and publishing.

Of total mergers and acquisitions in 1990, 3,244 deals valued at $107.2 billion represent U.S. companies acquired by U.S. companies, 599 deals valued at $47.6 billion represent U.S. companies acquired by foreign companies, and 325 deals valued at $17.5 billion represent foreign companies acquired by U.S. companies.

Foreign acquisitions of U.S. companies in 1990 concentrated in services, finance, insurance, real estate, chemicals and allied products, industrial machinery and computer equipment, wholesale trade, paper and allied products, printing and publishing. U.S. acquisitions of foreign companies concentrated in services, wholesale trade, industrial machinery and computer equipment, chemicals and allied products, transportation, and public utilities (table 2).

Table 1
Mergers and acquisitions, 1980-90

	1980	1983	1984	1985	1986	1987	1988	1989	1990
Total									
Number	1,559	2,395	3,176	3,589	4,463	4,024	4,233	4,167	4,168
Value billion dollars	32.8	52.7	126.2	146.0	206.0	178.0	240.2	254.0	172.3
Divestiture									
Number	104	661	794	1,041	1,419	1,221	1,336	1,333	1,406
Value billion dollars	5.1	12.9	30.6	43.5	72.4	57.8	84.0	66.7	59.6
Leveraged buyouts									
Number	11	231	254	255	337	279	383	382	254
Value billion dollars	0.2	4.5	18.7	19.7	45.2	36.2	47.1	66.9	16.0
Form of payment									
All cash (percent)	8	24	36	40	43	54	60	43	46
All stock (percent)	19	13	12	10	12	11	5	10	6
Combination, cash, stock debt, other (percent)	17	28	26	24	20	18	25	37	33
Undisclosed (percent)	56	35	26	26	25	17	10	10	15
Ownership status of acquisition targets									
Public acquired company									
Number	398	554	835	823	865	1,011	984	1,124	915
Value billion dollars	12.0	31.9	85.7	91.6	109.2	103.0	130.4	168.8	90.0
Private acquired company									
Number	1,059	1,195	1,555	1,621	2,168	1,739	1,848	1,600	1,695
Value billion dollars	15.9	8.3	10.1	10.6	24.5	15.1	24.1	18.2	17.9

Source: MLR Publishing Co., "*Mergers and Acquisitions, 1991*," *Statistical Abstract of the United States, 1993*, p. 543.

It remains to be seen whether the current wave of acquisition activity, whose main feature seems to be friendly rather than hostile takeovers, will result in greater economies of scale or "managerial entrenchment."

U.S. International Transactions

Current account

The U.S. Department of Commerce reported (table 3) that the U.S. current-account deficit increased to $37.0 billion in the second quarter of 1994 from $32.3 billion in the first quarter because of the increases in the deficits on goods and on investment income, and because of the rise in net unilateral transfers.

The deficit in goods and services increased to $27.0 billion in the second quarter from $24.3 billion in the first. The deficit in merchandise trade increased to $41.8 billion from $37.0 billion. Exports in the second quarter increased to $122.7 billion from $118.0 billion in the first quarter as imports increased to $164.4 billion from $155.0 billion. The surplus in services increased to $14.8 billion in the second quarter from $12.6 billion in the first. Services receipts increased to $48.5 billion from $46.9 billion due to the increase in travel receipts. Services payments decreased to $33.7 billion from $34.2 billion because of the decrease in travel, royalties and license fees, and other private payments.

The deficit on investment income increased to $2.5 billion in the second quarter from $0.8 billion in the first. Income receipts on U.S. assets abroad increased to $32.3 billion from $29.9 billion, reflecting higher interest rates and receipts of past due interest payments owed to U.S. banks by Brazil. Direct investment receipts also increased. Income payments on foreign assets in the United States increased to $34.8 billion from $30.7 billion. Direct investment payments were also sharply higher. Net unilateral transfers showed outflows of $7.5 billion in the second quarter, compared with outflows of $7.2 billion in the first.

Capital account

Net recorded capital inflows declined to $40.5 billion in the second quarter, compared with inflows of $46.8 billion in the first. Acquisitions of foreign assets by U.S. residents and acquisitions of U.S. assets by foreign residents both slowed sharply.

U.S. assets abroad increased by $1.8 billion in the second quarter, compared with an increase of $48.2 billion in the first due to the sharp slowdowns in private capital outflows. Net U.S. purchases of foreign securities declined to $12.5 billion in the second quarter, from $24.6 billion in the first. Net U.S. purchases of foreign stocks were $9.7 billion, down from $17.4 billion, and net U.S. purchases of foreign bonds were $2.8 billion, down from $7.2 billion. Net capital outflows for U.S. direct investment abroad declined sharply to $7.8 billion in the second quarter, from $24.8 billion in the first.

Table 2
Mergers and acquisitions: Number and value of transactions, by industries, 1990

Industry	Total		U.S. company acquiring U.S. company		Foreign company acquiring U.S. company		U.S. company acquiring foreign company	
	Number	Value	Number	Value	Number	Value	Number	Value
		Billion dollars		Billion dollars		Billion dollars		Billion dollars
Total activity	4,168	172.3	3,244	107.2	599	47.6	325	17.5
Agriculture, forestry, & fishing	13	0.6	10	0.1	3	.3	1	n/a
Mining	208	11.6	165	6.4	29	5.1	14	.2
Construction	35	.3	30	.2	5	.1	–	–
Manufacturing								
Food & kindred products	92	9.3	65	3.7	16	.8	11	4.8
Textile mill products	29	.2	21	.1	1	.1	7	.1
Apparel & other textile products	25	.5	21	.1	1	.4	3	n/a
Lumber & wood products	14	.3	10	.2	3	.1	1	n/a
Paper & allied products	41	5.7	24	5.33	4	.2	13	.1
Printing & publishing	130	3.9	95	2.2	29	1.3	6	.5
Chemicals & allied products	193	15.6	119	3.8	54	11.5	20	.3
Rubber & plastic products	53	2.3	40	1.4	6	.9	7	–
Stone, clay, glass & concrete	43	4.8	21	1.6	17	3.0	5	.2
Primary metals industries	51	1.6	32	.6	17	.3	2	.6
Fabricated metal products	89	2.7	64	1.5	21	1.0	4	2
Industrial machinery, computer equipment	233	6.0	170	4.3	43	1.6	20	.1
Electrical & electronic equipment	186	6.4	131	3.9	37	1.8	18	.7
Transportation equipment	63	4.8	40	1.6	12	.6	11	2.7
Instruments & related products	144	2.8	108	1.1	26	1.7	10	–
Transportation & public utilities	343	19.8	292	14.2	32	1.3	19	4.3
Wholesale trade	266	3.1	190	1.9	38	1.0	38	.2
Retail trade	158	7.4	126	4.7	23	2.6	9	.1
Finance, insurance, real estate	905	28.1	808	[illegible]1.3	78	6.0	19	0.8
Services	744	32.8	385	26.2	86	5.5	73	1.1

Source: MLR Publishing Co., "*Mergers and Acquisitions, 1991*," *Statistical Abstract of the United States, 1993*, p. 543.

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Table 3
U.S. International transactions, 1993- 1994-IIQ

(Million of dollars, seasonally adjusted)

Items	1993	I-Q	II-Q	1994 I-Qr	II-Qp
Exports of goods, services, and income	755,533	184,968	188,906	194,760	203,420
Merchandise, adjusted, excl. military[1]	456,866	111,664	113,787	118,018	122,670
Services[2]	184,811	45,577	46,318	46,854	48,480
Income receipts on U.S. assets abroad	113,856	27,727	28,801	29,888	32,270
Direct investment receipts	57,515	13,893	14,663	15,032	15,396
Other private receipts	51,272	12,556	12,880	13,849	15,832
U.S. Government receipts	5,070	1,278	1,258	1,007	1,042
Imports of goods, services, and income	-827,312	-197,535	-207,308	-219,899	-232,926
Merchandise, adjusted, excl. military[1]	-589,441	-140,855	-147,514	-154,980	-164,441
Services[2]	-127,961	-30,808	-31,661	-34,220	-33,720
Income payments on foreign assets in the United States	-109,910	-25,872	-28,133	-30,699	-34,765
Direct investment payments	-5,110	-246	-1,970	-3,559	-4,648
Other private payments	-63,239	-15,433	-15,956	-16,335	-18,896
U.S. Government payments	-41,561	-10,193	-10,207	-10,805	-11,221
Unilateral transfers, net	-32,117	-7,283	-7,200	-7,178	-7,464
U.S. assets abroad, net (increase/capital outflow (-))	-147,898	-12,659	-35,966	-48,236	-1,827
U.S. official reserve assets, net	-1,379	-983	822	-59	3,537
U.S. credits and other long-term assets	-6,024	-943	-750	-747	-984
Repayments on U.S. credits and other long-term assets	6,026	1,763	874	1,108	930
U.S. private assets, net	-146,213	-12,164	-36,507	-48,667	-5,147
Direct investment	-57,870	-11,202	-17,675	-24,767	-7,802
Foreign securities	-119,983	-24,517	-24,340	-24,605	-12,486
U.S. claims reported by U.S. banks, not incl. elsewhere	32,238	28,601	5,595	-1,236	15,141
Foreign assets in the United States, net (increase/capital inflow(+))	230,698	16,772	51,829	95,078	42,329
Foreign official assets in the United States, net	71,681	10,968	17,492	11,530	7,869
U.S. Government securities	52,764	1,745	6,750	1,243	8,651
U.S. Treasury securities	48,702	1,080	5,668	1,193	6,168
Other	4,062	665	1,082	50	2,483
Other U.S. Government liabilities	1,666	-438	158	938	121
U.S. liabilities reported by U.S. banks, not incl. elsewhere	14,666	8,257	9,485	10,139	53
Other foreign official assets	2,585	1,404	1,099	-790	-956
Other foreign assets in the United States, net	159,017	5,804	34,337	83,548	34,460
Direct investment	21,366	1,434	8,869	11,963	3,905
U.S. Treasury securities	24,849	14,001	-622	9,260	-7,662
U.S. securities other than U.S. Treasury securities	80,068	9,590	15,025	21,258	13,447
U.S. liabilities to unaffiliated foreigners reported by U.S. non-banking concerns	14,282	774	7,606	5,867	N.A.
U.S. liabilities reported by U.S. banks, not included elsewhere	18,452	-19,995	3,459	35,200	24,770
Statistical discrepancy	21,096	15,737	9,739	-14,525	-3,532
of which seasonal adjustment discrepancy	6,105	435	-6,643	103	480
Balance on merchandise trade	-132,575	-29,191	-33,727	-36,962	-41,771
Balance on services	56,850	14,769	14,657	12,634	14,760
Balance on goods and services	-75,725	-14,422	-19,070	-24,328	-27,011
Balance on investment income	3,946	1,855	668	-811	-2,495
Balance on goods, services, and income	-71,779	-12,567	-18,402	-25,139	-29,506
Unilateral transfers, net	-32,117	-7,283	-7,200	-7,178	-7,464
Balance on current account	-103,896	-19,850	-25,602	-32,317	-36,970
Net capital outflow (-), inflow (+)	+92,800	+4,113	+15,863	+46,848	+40,502

r Revised. p Preliminary. n.a. not available.

[1] Adjusted for timing, valuation, and coverage to balance of payments basis; excludes exports under U. S. military agency sales contracts and imports of U. S. military agencies.

[2] Includes some goods that cannot be separately identified from services.

Note.—Because of rounding, details may not add to totals.

Source: U. S. Department of Commerce, Bureau of Economic Analysis.

Foreign assets in the United States increased by $42.3 billion in the second quarter, compared with an increase of $95.1 billion in the first. Transactions in U.S. Treasury securities shifted to net foreign sales of $7.7 billion in the second quarter, from net foreign purchases of $9.3 billion in the first, reflecting, in part, declining bond prices.

Net foreign purchases of U.S. securities other than U.S. Treasury securities declined to $13.4 billion in the second quarter, from $21.3 billion in the first quarter. Transactions in U.S. stocks shifted to net foreign sales of $1.6 billion, from net foreign purchases of $6.6 billion, as U.S. stock prices were well below peak first-quarter levels.

Net capital inflows for foreign direct investment in the United States declined to $3.9 billion in the second quarter, from $12.0 billion in the first quarter. Foreign official assets in the United States increased by $7.9 billion in the second quarter, compared with an increase of $11.5 billion in the first quarter.

U.S. Economic Performance Relative to Other Group of Seven (G-7) Members

Economic Growth

Real GDP—the output of goods and services produced in the United States measured in 1987 prices—grew at a 3.8-percent annual rate in the second quarter of 1994, following a revised annual rate of 3.3 percent in the first quarter. The annualized rate of real economic growth in the second quarter of 1994 was 6.4 percent in Canada, -1.6 percent in Japan, 4.0 percent in the United Kingdom, 4.0 percent in Germany, 4.1 percent in France, and 0.3 percent in Italy.

Industrial Production

Industrial production rose 0.7 percent in August after a revised increase of 0.3 percent in July. A resurgence in assemblies of motor vehicles accounted for the acceleration of industrial production in August. Gains in the output of machinery and components (including computers) used to make equipment and motor vehicles contributed most of the remaining growth. The index of total industrial production was 6.7 percent higher in August than it was a year earlier. The substantial growth in output boosted the utilization of total industrial capacity to 84.7 percent, up from 81.4 percent a year earlier.

Other G-7 member countries reported the following annual growth rates of industrial production. For the year ending July 1994: the United Kingdom reported an increase of 4.8 percent, Germany reported an increase of 7.5 percent, and Japan reported a decrease of 0.5 percent. For the year ending June 1994: Italy reported an increase of 4.5 percent, and France reported an increase of 3.1 percent. For the year ending May 1994: Canada reported an increase of 6.1 percent.

Prices

The seasonally adjusted Consumer Price Index (CPI) increased by 0.3 percent in August, the same as in July and June 1994. The CPI advanced by 2.9 percent during the 12 months ending August 1994.

During the 1-year period ending August 1994, prices increased by 3.7 percent in Italy, 3.0 percent in Germany, 2.4 percent in the United Kingdom, 1.7 percent in France, -0.2 percent in Japan, and 0.2 percent in Canada.

Employment

Employment continued to rise in August and the unemployment rate was unchanged at 6.1 percent, according to the U.S. Department of Labor. Nonfarm payroll employment increased 179,000. Joblessness among the major labor force groups in August remained virtually unchanged. The unemployment rates for adult men was 5.4 percent, adult women 5.4 percent, teenagers 17.5 percent, whites 5.3 percent, blacks 11.5 percent, and Hispanics 10.2 percent.

Manufacturing employment grew by 32,000 in August. Most of the jobs added over the month were in the durable goods sector. Motor vehicles employment rose by 10,000 and fabricated metals by 9,000, reflecting strength in the auto industry and the reopening of plants that were closed for retooling. There also were sizable employment increases in electrical equipment and industrial machinery. Within the nondurable goods sector, gains continued in printing and publishing, and there were small increases in apparel and tobacco products.

Construction employment held about steady in August, following 13 consecutive months of growth during which construction industry payrolls were augmented by more than 300,000 workers. The services industry added 123,000 workers in August. The gains took place largely in business (53,000), health (38,000), and social services (22,000). The large gain in health services payrolls included a rebound in hospital employment.

Retail trade employment was essentially flat in August, and wholesale trade employment rose by 18,000 in August. Real estate added 6,000 jobs, continuing its 2-year uptrend. Within finance, jobs continued to decline in nondepository institutions (primarily in mortgage banking), while growth was sustained in security brokers and other types of investment companies. Federal Government employment has held steady in the last 2 months, after declining by 124,000 since its April 1992 peak.

In other G-7 countries, unemployment in August 1994 was 12.6 percent in France, 11.6 percent in Italy, 10.3 percent in Canada, 9.2 percent in the United Kingdom, 8.3 percent in Germany, and 3.0 percent in Japan. (For foreign unemployment rates adjusted to U.S. statistical concepts, see the tables at the end of this issue.)

Forecasts

Forecasters expect real growth in the United States to average around 2.8 percent in the third quarter of 1994 and remain around this level in the first half of 1994. Factors that may restrain the recovery in 1994 include the impact of rising interest rates on new investment, output and incomes, and the contractionary impact of the decline in government spending. Table 4 shows macroeconomic projections for the U.S. economy for July 1994 to September 1995, by six major forecasters, and the simple average of these forecasts. Forecasts of all the economic indicators except unemployment are presented as percentage changes over the preceding quarter, on an annualized basis. The forecasts of the unemployment rate are averages for the quarter.

The average of the forecasts points to an unemployment rate of 6.1 percent in the remainder of 1994, then a decline to 6.0 percent in the first two quarters of 1995. Inflation—as measured by the GDP deflator—is expected to remain subdued at an average rate of about 2.6 to 2.7 percent from the third quarter until the fourth quarter of 1994, and then rise slightly in the first quarter of 1995. A slow rise in labor costs, wages, and compensation are expected to hold down inflation rates.

Table 4
Projected changes of selected U.S. economic indicators, by quarters, Apr. 94-Mar. 95
(Percent)

Period	Conference Board	E.I. Dupont	UCLA Business Forecasting Project	Merrill Lynch Capital Markets	Data Resources Inc. (D.R.I.)	Wharton WEFA Group	Mean of 6 forecasts
	GDP current dollars						
1994:							
July-Sept.	5.9	4.8	4.8	4.2	4.5	4.7	4.8
Oct.-Dec	7.2	5.5	4.2	5.7	5.1	5.5	5.5
1995							
Jan.-Mar.	7.4	5.6	5.0	5.8	4.8	6.3	5.8
Apr.-June.	7.4	5.8	5.2	5.7	3.8	5 7	5.6
	GDP constant (1987) dollars						
1994:							
July-Sept.	2.7	1.9	1.7	1.8	2.8	2.0	2.1
Oct.-Dec.	4.1	2.2	1.9	3.2	2.6	2.7	2.8
1995:							
Jan.Mar.	4.2	2.4	2.4	2.9	1.9	3.0	2.8
April-June.	4.5	2.6	2.9	3.1	1.4	3.0	2.9
	GDP deflator index						
1994:							
July-Sept	3.1	2.9	2.8	2.3	2.1	2.7	2.6
Oct.-Dec.	3.0	3.2	2.3	2.4	2.4	2.7	2.7
1995:							
Jan.-Mar.	3.0	3.2	2.5	2.8	2.8	3.2	2.9
April-June.	2.7	3.1	2.2	2.8	2.4	2.6	2.6
	Unemployment, average rate						
1994:							
July-Sept.	6.1	6.1	6.2	6.1	6.1	6.2	6.1
Oct.-Dec	6.0	6.0	6.2	6.1	6.0	6.1	6.1
1995:							
Jan.-Mar.	5.9	6.0	6.1	6.1	5.9	6.1	6.0
April-June.	5.8	5.9	6.2	6.0	5.9	6.0	6.0

Note.—Except for the unemployment rate, percentage changes in the forecast represent compounded annual rates of change from preceding period. Quarterly data are seasonally adjusted. Date of forecasts: Oct. 1994.

Source: Compiled from data provided by the Conference Board. Used with permission.

U.S. TRADE DEVELOPMENTS

The U.S. Department of Commerce reported that seasonally adjusted exports of goods and services of $56.5 billion and imports of $67.5 billion in July 1994 resulted in a goods and services trade deficit of $11.0 billion, $2.0 billion more than the June deficit of $9.0 billion. The July 1994 deficit was $3.5 billion more than the deficit registered in July 1993 ($7.45 billion) and $2.9 billion higher than the average monthly deficit registered during the previous 12 months ($8.1 billion). A decline in exports of commercial airplanes and the rise in oil prices led to the increase in the merchandise trade deficit in July 1994.

The July trade deficit in goods was $15.7 billion, approximately $1.7 billion more than the June deficit of $14.0 billion. The July services surplus was $4.7 billion, approximately $0.3 billion less than the June surplus of $5.0 billion due to the increase in travel.

Seasonally adjusted U.S. trade in goods and services in billions of dollars as reported by the U.S. Department of Commerce is shown in table 5. Nominal export changes and trade balances for specific major commodity sectors are shown in table 6. U.S. exports and imports of goods with major trading partners on monthly and year-to-date bases are shown in table 7, and U.S. trade in services by major category is shown in table 8.

Table 5
U.S. trade in goods and services, seasonally adjusted, June-July 1994

(Billion dollars)

Item	Exports July 94	Exports June 94	Imports July 94	Imports June 94	Trade balance July 94	Trade balance June 94
Trade in goods (BOP basis)						
Current dollars—						
Including oil	40.3	42.0	56.0	56.0	-15.7	-14.0
Excluding oil	40.6	42.3	50.7	50.9	-10.1	-8.6
Trade in services						
Current dollars	16.1	16.3	11.4	11.4	4.7	5.0
Trade in goods and services						
Current dollars	56.5	58.4	67.5	67.4	-11.0	-9.0
Trade in goods (Census basis)						
1987 dollars	40.2	41.7	53.9	54.3	-13.7	-12.6
Advanced-technology products (not seasonally adjusted)	9.1	10.4	7.8	8.3	1.3	2.1

Note.—Data on goods trade are presented on a Balance-of-Payments (BOP) basis, which reflects adjustments for timing, coverage, and valuation of data compiled by the Census Bureau. The major adjustments on BOP basis exclude military trade but include nonmonetary gold transactions, and estimates of inland freight in Canada and Mexico, not included in the Census Bureau data.

Source: *U.S. Department of Commerce News (FT 900)*, Sept. 1994.

Table 6
Nominal U.S. exports and trade balances, of agriculture and specified manufacturing sectors, Jan. 1993-July 1994

Sector	Exports Jan.-July 1994	Exports July 1994	Change Jan.-July 1994 over Jan.-July 1993	July 1994 over June 1994	Share of total, Jan.-July 1994	Trade balances, Jan.-July 1994
	Billion dollars		Percent			Billion dollars
ADP equipment & office machinery	17.0	2.4	10.4	-11.1	5.9	-10.80
Airplane	11.4	.8	-8.8	-50.0	4.0	9.00
Airplane parts	5.6	.8	3.7	0	1.9	4.00
Electrical machinery	24.9	3.6	19.1	-5.3	8.7	-6.10
General industrial machinery	12.2	1.8	8.0	-5.3	4.3	-0.01
Iron & steel mill products	2.0	.3	0	0	.7	-5.10
Inorganic chemicals	2.2	.4	-8.3	33.3	.8	0.00
Organic chemicals	7.1	1.1	9.2	10.0	2.5	0.80
Power-generating machinery	11.6	1.5	3.6	-16.7	4.0	0.50
Scientific instruments	9.4	1.3	6.8	-13.3	3.3	3.90
Specialized industrial machinery	11.1	1.6	7.8	-5.9	3.9	1.30
Telecommunications	8.7	1.3	20.8	-7.1	3.0	-8.10
Textile yarns, fabrics and articles	3.6	.5	5.9	0	1.3	-1.60
Vehicle parts	11.4	1.2	1.8	-36.8	4.0	0.10
Other manufactured goods[1]	16.2	2.5	6.6	0	5.6	-6.80
Manufactured exports not included above	73.5	9.9	11.7	-9.2	25.6	-87.30
Total manufactures	227.9	31.0	8.8	-10.4	79.4	-77.50
Agriculture	24.2	3.1	0	-3.1	8.4	9.40
Other exports not incl. above	35.1	5.2	4.1	-7.1	12.2	-9.20
Total exports of goods	287.2	39.3	7.4	-9.5	100.0	-77.30

[1] This is an official U.S. Department of Commerce commodity grouping.

Note.—Because of rounding, figures may not add to the totals shown. Data are presented on a Census basis.

Source: *U.S. Department of Commerce News (FT 900)*, Sept. 1994.

Table 7
U.S. exports and imports of goods with major trading partners, Jan. 1993-July 1994
(Billion dollars)

Country/area	Exports July 94	Exports Jan.-July 94	Exports Jan.-July 93	Imports July 94	Imports Jan.-July 94	Imports Jan.-July 93
North America	11.9	92.0	82.0	12.6	97.4	86.2
Canada	7.7	63.3	57.8	9.0	70.5	63.7
Mexico	4.2	28.7	24.2	3.6	27.0	22.5
Western Europe	8.7	67.7	66.4	11.1	73.5	65.5
European Union (EU)	7.5	58.7	56.6	9.4	62.5	55.4
Germany	1.4	10.8	5.0	2.8	17.9	16.2
European Free-Trade Association (EFTA)[1]	1.0	7.0	7.3	1.5	9.8	9.1
FSU/Eastern Europe[2]	0.4	2.9	3.4	0.5	3.0	1.8
FSU	0.2	2.0	2.0	0.3	1.9	1.1
Russia	0.1	1.5	1.4	0.3	1.6	0.9
Pacific Rim Countries	12.3	83.1	74.9	22.7	142.3	126.4
Australia	0.9	5.4	4.7	0.3	1.8	1.9
China	1.0	5.6	4.7	3.6	20.0	16.5
Japan	4.4	30.2	28.2	10.0	66.3	59.8
NICs[3]	4.8	32.9	30.0	6.1	38.9	35.9
South/Central America	3.3	22.5	20.9	3.2	21.3	19.9
Argentina	0.3	2.6	1.9	0.1	1.0	0.7
Brazil	0.7	4.1	3.3	0.8	4.9	4.1
OPEC	1.3	10.1	11.1	3.1	17.3	19.4
Total	39.3	287.2	267.41	54.7	364.5	327.5

[1] EFTA includes Austria, Finland, Iceland, Liechtenstein, Norway, Sweden, and Switzerland.

[2] Former Soviet Union.

[3] The newly industrializing countries (NICs) include Hong Kong, the Republic of Korea, Singapore, and Taiwan.

Note.—Country/area figures may not add to the totals shown due to rounding. Exports of certain grains, oilseeds and satellites are excluded from country/area exports but included in total export table. Also some countries are included in more than one area. Data are presented on a Census Bureau basis.

Source: *U.S. Department of Commerce News (FT 900)*, Sept. 1994.

Table 8
Nominal U.S. exports and trade balances of services by sector, Jan. 1993-July 1994, seasonally adjusted

Sector	Exports		Change		Trade balances	
	Jan.-Dec. 93	Jan.-July 94	Jan.-Dec. 93 over Jan.-Dec. 92	Jan.-July 94 over Jan.-July 93	Jan.-Dec. 93	Jan.-July 94
	Billion dollars		Percent		Billion dollars	
Travel	57.6	35.0	6.2	5.1	17.06	9.20
Passenger fares	16.5	9.8	-2.5	1.0	5.13	2.60
Other transportation	23.1	14.0	2.0	3.7	-1.35	-0.60
Royalties and license fees	20.4	12.5	2.4	5.3	15.56	9.10
Other private services[1]	54.9	33.6	7.6	6.7	22.75	13.20
Transfers under U.S. military sales contracts	11.4	6.1	5.4	-15.0	-0.77	-0.40
U.S. Govt. miscellaneous services	0.8	0.4	-5.8	-18.0	-1.53	-1.10
Total	184.8	111.5	4.7	3.7	56.85	32.10

[1] "Other private services" consists of transactions with affiliated and unaffiliated foreigners. These transactions include educational, financial, insurance, telecommunications, and technical services—such as business, advertising, computer and data processing, and other information services, the latter which include such services such as engineering, consulting, etc.

Note.—Services trade data are on a Balance-of-Payments (BOP) basis. Numbers may not add to totals because of seasonal adjustment and rounding.

Source: *U.S. Department of Commerce News (FT900)*, Sept. 1994.

INTERNATIONAL TRADE DEVELOPMENTS

First USITC Report on Andean Trade Preferences Released

The U.S. International Trade Commission's (USITC) first report on the impact of the Andean Trade Preference Act (ATPA) was sent to Congress on September 30. The report, mandated by the ATPA, requires the Commission to report annually on the impact of the preferences extended by the act on three matters: (1) U.S. industries, (2) U.S. consumers, and (3) drug crop eradication and crop substitution efforts in the Andean region. Reports in the series will continue as long as the preference program is in effect. The program, as currently defined, is due to expire at the end of 2001.

The ATPA was signed into law in December 1991 as part of the United States' "war on drugs." Its passage culminated a 2-year effort by the Bush administration to identify ways the United States could encourage the Andean countries to reduce drug crop cultivation and production. ATPA goals are to promote broad-based economic development, stimulate investment, and diversify the Andean countries' export base. To this effect, ATPA establishes a preferential tariff regime for certain Andean products, thereby improving access to the U.S. market for Andean suppliers relative to others. Four countries are eligible for ATPA benefits: Bolivia, Colombia, Ecuador, and Peru. President Bush designated Colombia and Bolivia as eligible for ATPA benefits in July 1992. President Clinton designated Ecuador in April 1993, and Peru in August 1993.

Highlights follow, of the Commission's first report on ATPA:

- The United States is the single largest trading partner of Bolivia, Colombia, Ecuador, and Peru. The United States recorded a $77 million trade surplus with the Andean countries in 1993, with exports valued at nearly $5.4 billion and imports of approximately $5.3 billion. The leading U.S. exports to the four Andean countries increasingly are such manufactured goods as nonelectrical machinery, chemicals, transportation equipment, and electrical and electronic equipment, although cereals such as wheat and corn also are important U.S. exports. The leading U.S. imports are petroleum, agricultural products and livestock, and textiles and apparel.

- Despite the brief history of operative ATPA, U.S. imports from the ATPA countries reached $401 million in 1993. Several factors suggest that ATPA may lead to increased Andean exports to the United States. ATPA provides preferential tariff treatment for some 6,000 Andean products, versus preferential treatment for only about 4,000 products also available to Andean products under the U.S. Generalized System of Preferences (GSP) program. ATPA and GSP share several similarities, and many products may be entered under either program. Unlike GSP, ATPA allows for U.S. content to be included in the 35 percent local value-added calculation, and contains no "competitive need" limits to restrict exports and end duty-free access after specified thresholds are met. Indeed, many products previously entered under GSP now enter under ATPA to avoid GSP competitive need limits (for example, chrysanthemums from Colombia) or to take advantage of ATPA's more liberal APTA rules of origin (for example, certain gold jewelry from Bolivia). Current trends indicate that ATPA imports soon will exceed Andean GSP imports ($448 million in 1993).

- Colombia, the largest country in the region, dominates ATPA and supplied 80 percent of all ATPA imports in 1993. Over 71 percent of these imports from Colombia were fresh cut flowers, including chrysanthemums and roses. Fresh cut flowers were the single largest

ATPA import category, accounting for 60 percent of total imports under the Act.

- Despite the strong growth of imports, ATPA has had little overall impact on the U.S. economy. Imports from ATPA countries represented less than 0.1 percent of total U.S. imports. (Indeed, total imports from the four ATPA countries accounted for less than 1.0 percent of total U.S. imports in 1993.) ATPA does not provide preferential tariffs for most import-sensitive items such as textiles.

- The Commission used a partial-equilibrium analysis to determine the effect of the ATPA on U.S. consumers, and on competing U.S. industries. In 1993, the gains to consumers were greater than the corresponding loss in tariff revenues to the U.S. Treasury resulting from ATPA duty reduction. The six items with the highest net welfare gains were chrysanthemums, standard carnations, anthuriums, and orchids; roses; asparagus; glazed ceramic tiles and cubes; glazed ceramic flagstone and paving; and stemmed tobacco. At most, less than 1 percent of U.S. output of each product was displaced by ATPA imports. In terms of domestic shipments, the largest displacement effects occurred for the two categories of fresh cut flowers—9.2 percent in the case of roses valued at $14.9 million, and 17.9 percent in the case of chrysanthemums valued at $8.8 million.

- The probable future effects of ATPA on U.S. industries could be more significant. Public and private sector officials in the Andean countries have identified a variety of nontraditional products as potential exports to the U.S. market. Among them are beef and seafood, fresh horticultural products (such as hearts of palm, pineapple, tomatoes, broccoli, asparagus, tropical fruits, melons, strawberries, figs, pomegranates, spices, nuts, cut flowers, and ornamental plants) and processed foods (including tomato paste and catsup, frozen broccoli, canned pineapple, and fruit juices, purees, and concentrates). Manufactured items identified included gold jewelry and wood products.

- However, several factors could frustrate the Andean countries' efforts to attract investment and increase nontraditional exports. Inadequate infrastructure, particularly in transportation and cargo-handling facilities, limited export-financing, poor product quality, and continued concerns about personal safety and private property protection may impede such efforts.

- A number of U.S. agencies are involved in antidrug efforts in the Andean region. Evidence of the performance of crop eradication and substitution programs in the region suggests that they have had, at best, mixed success so far. Eradication has been taking place, but achievements have been less than stated objectives. Such efforts appear to garner limited support by the Andean governments and enforcement authorities. Bolivia has no forcible eradication policy, and Peru has not had any eradication since 1989. Crop substitution and diversification are also occurring, but on a relatively small scale. Few products can viably replace coca because few offer the secure promise of similar economic return, ease of marketability, and supportive infrastructure already present in the Andean cocaine industry.

- Given the newness of the program, no precise estimate of the impact of ATPA on drug-related crop eradication and crop substitution is possible at this time. To the extent that ATPA is effective in fostering economic growth and diversification in the years ahead, it should create new jobs and alternative sources of income—things that, it is generally agreed, are important ways to counter the growth of the regional cocaine industry.

Annual Report on the Impact of the Andean Trade Preference Act on U.S. Industries and Consumers and on Drug Crop Eradication and Crop Substitution, 1993 is the first in a series of reports on the effects of ATPA mandated by section 206 of the Act. Copies of this report are available through the U.S. Government Printing Office. To order this publication, indicate stock number 049-00074-0 and send your check for $6.00 ($7.50 foreign) per copy or provide your VISA or MasterCard number and expiration date to: Superintendent of Documents, P.O. Box 371954, Pittsburgh, PA 15220-7954. (FAX to 202-512-2250). In addition, the Department of Commerce's National Trade Data Bank will include the report in its November edition. Interested news media may contact the ITC's Office of Public Affairs at 202-205-1819 regarding this publication.

Mexico's Maquiladoras Will be Transformed by NAFTA

The North American Free Trade Agreement (NAFTA) will fundamentally change the nature of Mexico's maquiladora industry, the country's second-largest earner of foreign exchange (after petroleum). The maquiladora industry was formally established in 1965 under Mexico's Border Industrialization Program, which had only 12 plants that year. Growing at a spectacular rate, the facilities under the program, most of them foreign-owned, numbered well above 2,100 and employed more than one-half million workers by the end of 1993. In 1993, maquiladora exports, valued at $19.8 billion, were led by electronics, transport equipment, electronic machinery, and apparel and other textile products.

The initial purposes of the maquiladora program were to attract foreign investment and facilitate technology transfer into Mexican industry, and to provide employment opportunities in the U.S.-Mexico border region. The term "maquiladora" derives from the Spanish word "maquilar," which refers to arrangements where, in exchange for providing milling services, a miller retains a portion of the flour he makes. By analogy, all facilities participating in the maquiladora program (the "maquilas") share the characteristic that they involve the processing or assembly of primarily foreign inputs. In establishing the program, the Mexican Government allowed these foreign materials and components duty-free importation, regardless of their origin, if the finished product were to be exported rather than sold on the domestic market.

NAFTA is scheduled to alter the two bases of the maquiladora program: (1) it will terminate the mandated export orientation that was assured first by full prohibition of, and later by major restrictions on, selling the maquila end product in Mexican markets; and (2) it will not allow the duty- free importation into Mexico of raw materials and components, regardless of their origin. Once these changes take place, the meaning of the "maquila" label will necessarily change to indicate simply assembly-type operations with no special customs or tariff privileges and conditions—if the "maquila" label is used at all. Meanwhile, it is believed that the industry now operating in the maquiladora program will continue to thrive but will be absorbed gradually into the mainstream of the Mexican economy.

After the Government of Mexico relaxed its "for exports only" rule in 1977 and 1989, maquilas were eventually allowed to sell up to 50 percent of their production on the domestic market. With the advent of NAFTA, the authorized domestic share of total sales is being raised further, by 5 percent each year through 2000. Thus, at the beginning of the next century, maquila firms will be free to sell up to 100 percent of their output domestically, and many will lose their "for exports only" or "principally for exports" characteristic that had set them apart from the rest of Mexican industry.

Second, the duty-free importation of raw materials into Mexican maquilas regardless of origin will eventually cease, officially terminating the program itself. In accordance with NAFTA rules of preference and with rules aimed at preventing circumvention of NAFTA parties' external duties, third-country (extraregional) imports destined for maquilas will be dutiable on the same terms as those destined for all other establishments. Goods from NAFTA partners will be, of course, free of duty if they meet rules of preference—as will the NAFTA goods for all other importers, not only the maquilas. However, third-country goods imported for processing in one NAFTA country and subsequently exported to another partner country will be subject to special duty assessment rules as they cross the partners' common border. NAFTA article 303 limits duty drawback or reductions on such goods to the smaller of either (1) the total amount of the duties paid or owed on importation of the third-country goods into the NAFTA country of processing, or (2) the total amount of duties paid on the subsequent shipments of goods to another NAFTA signatory. This provision minimizes the problems that might otherwise arise from the NAFTA parties' differing external duty rates.

Asian-owned maquilas producing electronic and electrical products are the principal firms expected to be affected, because they import most of their inputs from Asia. Accounting for only about 2 percent of total inputs, Mexican supplies have been considered in the past largely inadequate by the maquiladora industry. Therefore, the big challenge as well as the big opportunity for Mexican (and other North American) producers will be to step in and replace some of the maquilas' Far-Eastern and other third-country suppliers who might lose their competitive edge because of the new duties. Representatives of the maquiladora industry are reportedly addressing this issue already, eyeing the potential of possible Mexican suppliers, and the financing options available to them, to be ready by the year 2001.

Another anticipated effect of extraregional duties to be imposed on maquilas would be that third-country suppliers will decide to locate in Mexico (or elsewhere in North America) to avoid or to reduce duties. This development would seem desirable for the maquilas, because their accustomed and preferred supplies would thus be closer at hand and more assured. Such an outcome would also be desirable for Mexico, whose policy makers are counting on direct foreign investment from all sources to fuel economic growth and technological advance.

Third-country suppliers actually play a relatively minor role in Mexico's maquiladora industry, which was established primarily with the United States in mind, both as the supplier and the export market. It is from the United States that maquilas import three-quarters of their raw materials and components; likewise, maquilas reexport most of these U.S. inputs to the United States, following assembly or other processing in Mexico. The United States readmits the identifiable U.S. content free of duty under subheading 9802.00.60 and heading 9802.00.80 of the *Harmonized Tariff Schedule of the United States (HTS)*, formerly items 806.30 and 807.00 of the *Tariff Schedules of the United States*. In terms of the foreign value content in such imports from Mexico, the United States presently imposes duties both on the value added by Mexican operations and on the third-country content in such imports. However, when the implementation of NAFTA is complete, goods qualifying as NAFTA products will be free of duty when shipped from one party to another, and third-country content will be subsumed in the duty assessment process.

For U.S. interests, the major attraction of the maquiladora program has been Mexico's abundant supply of cheap labor and its proximity to U.S. corporate planners, engineers, and markets. U.S. parent companies and U.S. "twins" of Mexican maquilas have sought to increase the competitiveness of their end products by production sharing—that is, by assigning the labor-intensive portion of the production process to the maquilas, while retaining the capital-intensive, technologically more sophisticated phases of their operation in the United States.

Experts see no reason why the mutually rewarding production sharing between U.S. companies and Mexican maquilas should not continue in the NAFTA era. The advantages of performing assembly operations in Mexico will survive because the differential between U.S. and Canadian wages on one hand and Mexican wages on the other is expected to persist in the foreseeable future. Reasons for collaboration may become even stronger because the maquilas will be allowed to access the Mexican market for all their output by 2000. Serving that growing market should become easier with the improvements to both the infrastructure and environmental conditions that NAFTA is expected to spawn. Finally, and most important, there will be a powerful incentive for maquila operations to shift from third-country sourcing to North American sourcing, in order to benefit from NAFTA preferences.

Barter and Countertrade on the Rise Again

International deals involving barter and countertrade (BCT), which allow payment of a vendor or investor in goods and services rather than in convertible currencies, appear to be rising. In a rare consensus, economists consider BCT a poor alternative to currency-based trade. The major objection is that such deals cost firms more than currency-based trade and, by encouraging bilateral swaps between firms or nations, they may actually distort multilateral trade. Economists do agree, however, that BCT is still better than no trade at all.

BCT spread rapidly following the 1973 oil crisis, when spiraling energy prices led to unusually large trade deficits, and many developing countries sank deep into debt. These countries began to exert pressure on their trading partners to accept their products and services in lieu of convertible currencies. Firms in industrialized countries that wanted to sell to a developing country unable to finance its purchases through the commercial credit mechanism accepted products or services as payment, even if the resale of these items imposed extra costs on them. This alternative was deemed better than no trade at all. The expansion of trade within the former Eastern bloc and between this bloc of countries and the rest of the world added to the rise of BCT during the 1970s and 1980s. According to conservative estimates, the share of BCT increased from less than 2 percent of world trade prior to 1973 to an estimated 10 percent by the late 1980s and remains roughly at that level.

Since there are no precise statistics to measure changes in the level of BCT, particularly over the short term, analysts base their contention that the overall level of BCT transactions is currently rising on business news that indicate an increase in the size and number of transactions. They also have noted a growth in subscriptions to magazines specializing in BCT, and an increased attendance at international conferences dedicated to these trade practices. Examination of the world trade environment reveals several reasons for the renewed growth.

BCT Between Developed Countries and the Former Eastern Bloc

Trade is growing between the developed countries and the former Eastern bloc: Albania, Bulgaria, the Czech Republic, Hungary, Poland, Slovakia, Romania, the Baltic States, and the former Soviet republics. To some extent, new demand for BCT comes from firms in the developed countries, seeking repayment assurances and guarantees from their business partners in the East.

Market reforms in the former Eastern Bloc have allowed individual firms to engage freely in export and import transactions, but at their own risk. Although most of these firms would prefer more efficient currency-based trade, circumstances do not yet allow them that luxury. As a side effect of the state's withdrawal from direct intervention in the operations of enterprises, many newcomers to international trade in the former Eastern Bloc entered the foreign trade arena without appropriate guarantees to conduct private transactions. These soon found out that sometimes the only guarantee their foreign partners would accept is the commodity they produce or the service they perform.

Businesses from the developed countries generally do not demand assurances for each transaction from partners in Eastern Bloc countries that enjoy a relative macroeconomic stability, complete with a relatively high degree of internal currency convertibility. BCT transactions with firms from this group of countries, which include mainly those in the Central European Free-Trade Area—the Czech Republic, Hungary, Poland, and Slovakia—generally seek assurance only for the repayment of credit or for the repatriation of profits incidental to direct investment. The most typical form of BCT involving credit and profit guarantees with firms from these countries are buy-back (or compensation) deals. Under such deals, the developed country exporter or creditor receives full or partial repayment in products derived from the capital good he sold or helped buy with the credit he extended. For example, the agreement under which the Austrian bank Kreditanstalt extended a large loan to a Polish electric utility specified the following mechanism: the Polish utility sells electricity to the European grid. The receipts are deposited in an escrow account serving as both collateral and fund for repayment. (For a detailed description of the modalities of buyback and other BCT arrangements, see U.S. Department of Commerce, International Trade Administration, *International Countertrade, A Guide for Managers and Executives*, Aug. 1992.)

Additional assurances are often sought for deals involving partners in countries that do not enjoy macroeconomic stability or ready internal currency convertibility. Several former Soviet republics belong to this category. The most frequent forms of BCT with these countries involve simple barter, advance payment through escrow accounts, and counterpurchase agreements. Simple barter means a one-time transaction bound under a single contract that specifies the direct, cashless exchange of selected goods for another equivalent value, for example, exchanging machinery for bauxite.). Under arrangements involving advance payment through an escrow account (or export prefinancing), the former Eastern Bloc partner delivers first. The developed country partner proceeds to sell the shipment, often with the help of a specialized trading company, and deposits the receipts in an escrow account maintained by a commercial bank, located in a third country. The developed country partner delivers only after he has been paid from the escrow account. Counterpurchase means the full or partial repayment by one or several products unrelated to the original exported products. (For example, machinery and equipment are paid for by a number of agricultural commodities.) Under such an agreement, the former Eastern Bloc country partner imports in exchange for a short or long list of products that it would buy, or already has bought, from the domestic market.

New pressure on developed country firms to engage in BCT comes mainly from those former Eastern Bloc countries whose governments have imposed exchange controls in response to convertible currency shortages. Such is the case in most former Soviet republics where controls take the form of a requirement to surrender a portion of convertible currency export revenues, coupled with a system of reallocating them to importers. A firm in one of these countries that wants to export in order to purchase capital goods might find negotiating a BCT deal with the seller a much better solution than surrendering its convertible currency earnings and embarking on the lengthy and unpredictable process of regaining them from the authorities.

A further reason to ask for BCT is the real or perceived lack of marketing expertise. Many firms from the former Soviet republics ask their developed country partners to market their products and subtract the value of the service from the sales price of whatever the developed country firms sell them. All former Soviet republics use a large BCT component, both in trade among themselves and in that with the rest of the world, but Turkmenistan is the only such country that has adopted a trading system that openly favors BCT. (See *Countertrade Outlook*, Apr. 11, 1994). Although some of the transactions with

business partners in the former Soviet republics might seem complicated, executives involved in them say that they are often profitable.

Trade on Rise Among Traditional BCT-User Countries

Although increased trade between former Eastern Bloc countries and developed countries fuels BCT, there is evidence that trade among traditional BCT users is also on the rise. After declining sharply during 1990-92, trade between Eastern Europe—Albania, Bulgaria, the Czech Republic, Hungary, Slovakia, Poland, Romania—and the former Soviet republics is growing again (particularly trade with Russia and Ukraine). BCT plays a significant role in this trade, even if transactions are calculated in convertible currencies and in world prices. For example, in a recently concluded agreement, Poland delivers coal in return for iron ore and metallurgical semifinished products from Ukraine. (See *Countertrade Outlook*, Aug. 15, 1994) Moreover, China's foreign trade, which contains a large BCT component, is also growing with all partners, including the former Eastern Bloc.

The growing trade among the former Eastern Bloc countries and among these countries and China involves all of the above-mentioned forms of BCT. Some firms in the Central European Free-Trade Area, particularly those that are fully or partially owned by developed country firms, have the same relationship with partners from the rest of the former Eastern Bloc as with developed-country firms. They would prefer currency-based trade, but accept BCT as a necessity forced upon them by their partners' financial conditions.

Growth of BCT With Developing Countries

Analysts have noticed increased pressure for BCT in trade from several developing countries of Asia, including China, and Africa. Some of the factors behind the increased demand for BCT in trade between the developed countries and the former Eastern Bloc are also present in trade between the developed and the developing countries. In particular, like the former communist countries, many developing countries also have implemented market reforms, allowing enterprises to trade independently. Just like the newly independent firms in the former Eastern Bloc, many enterprises in the developing countries also lack the financial wherewithal to provide their developed country partners with sufficient guarantees, and they must offer their products and services in exchange. Some newcomers to foreign trade in the developing countries might also be uncertain about their ability to sell in world markets and might prefer that their developing country partners do the job for them.

Despite great efforts and some partial success by the international community to reduce or at least consolidate the current account deficits of developing countries, world debt keeps climbing. World debt, which increases from any one year to another by the sum of national current account deficits, amounted to $1.3 trillion during 1988-90, $1.4 trillion during 1991-92 and $1.5 trillion during 1993, and it continues to increase during 1994.

There are no data on the extent to which a rise in world debt causes an increase in BCT. However, it is apparent that the relentless growth of this debt encourages BCT over the longer term. At least some of the debtor country governments confronted with further widening of their current account deficits are tempted to engage directly in BCT and to mandate or recommend it or do both to fully or partially owned (so-called parastatal) firms. Sometimes debtor country governments create inadvertent incentives for private firms to resort to BCT through foreign exchange restrictions and administrative controls over export and import transactions. The pressure for BCT is particularly strong from heavily indebted countries. There is some evidence that BCT is also spreading in trade among the developing countries. For example, some parastatal trading companies in Asia have been mandated to use BCT to penetrate new markets. There is further evidence that BCT is growing between the developing countries and the former Eastern bloc. For example, under recently concluded agreements, Russia delivers surface-to-air missiles for coffee, sugar, and soybeans from Brazil, and it delivers tractors for agricultural products from Argentina. (See *Countertrade Outlook*, Aug. 15, 1994).

Growth To Accelerate

When BCT grows, it tends to accelerate. Its increased use leads to the expansion of the corporate infrastructure designed to deal with it and widens the range of its applicability through the learning process. In the aftermath of the 1973 oil shock, BCT was mainly a vehicle for financing trade turnovers with developing countries. By now, the international community has learned how to use these methods for financing capital projects and production-sharing ventures, for ensuring the repatriation of profits from investments, and for competitive bidding. Improvements in the efficiency of computer-based data

processing and communications also catalyze the spread of BCT deals by reducing the time and costs required for their conclusion and execution.

U.S. Views and Policy

The U.S. policy on BCT was developed in 1983, when the growth of these practices was in full swing. This policy, still in force to date, prohibits Federal agencies and their officials from promoting BCT practices and deals. However, both the Department of Commerce and the Department of State provide advisory assistance on BCT to U.S. businesses. The Financial Services and Countertrade Division of Commerce organizes and disseminates information on these practices, including information on their use in various countries. Posts of the State Department overseas also collect information on the subject in their respective host countries. U.S. companies receiving BCT offers from foreign countries are urged to consult with Commerce and State, as Mr. Pompiliu Verzariu, Director of the Financial Services and Countertrade Division, puts it "to help assess the costs and risks associated with various transactions."

U.S. Government officials and long-time private experts are not certain how long the current rise in BCT transactions will last. Several factors, including international efforts to ensure a smooth financing of current account deficits, the projected reduction in armaments trade that traditionally contained a large BCT component, and the commercialization of government procurement might militate against the growth of worldwide BCT.

United States Seeks To Crack Open the Auto Market in Korea

The United States has recently intensified efforts to open the Korean automobile market to imported vehicles. For more than a year, bilateral negotiations with Korea have focused on widening market access for foreign cars. As part of this effort, the U.S. Embassy in Seoul staged a minishow of autos this summer to coincide with the visit of U.S. auto industry officials to Korea. More recently, however, bilateral negotiations with Korea in mid-September yielded no progress in opening the market to automobile imports. On October 3, 1994, the United States Trade Representative declined to designate Korea's market access for automobiles under super 301 procedures. Bilateral negotiations on the subject, however, are continuing.

The main concern of the U.S. Government and industry is the Korean public's perception that purchasing an imported automobile will trigger tax audits and other government scrutiny. Korean tax authorities have often used ownership of a foreign automobile as the basis for conducting tax audits of individuals. In February 1993, Korea's Assistant Minister of Trade announced that ownership of a foreign automobile would no longer trigger a tax audit by the Office of National Tax Audits. During the summer of 1994, Korea announced that it plans to phase out government forms that require taxpayers to disclose the make of their vehicles.

The United States, however, is concerned because Korean consumers continue to fear tax audits or other government discrimination if they purchase a foreign automobile. In addition, U.S. automakers, who are targeting the small but growing market for large autos in Korea, must counter other perceptions. Korean consumers believe that large, imported vehicles are extravagant, energy-inefficient, difficult to handle in Korean traffic, subject to high markups, and costly to maintain. Finally, motor vehicles are subject to several taxes or bonds in Korea. Although applied to both foreign and domestic vehicles, the taxes, which are calculated based on engine size, in effect discriminate against large U.S. vehicles, such as those U.S. automakers are seeking to sell. U.S. officials estimate that Korea's taxes and other charges increase the price of imported autos by 150 percent.

In June, Andrew Card, President of the American Automobile Manufacturer's Association, visited Seoul as part of the U.S. auto industry's effort to improve market access in Korea. The visit included a minishow of autos and a reception at the Ambassador's residence attended by high-level Korean Government officials. Each of the Big Three U.S. automakers displayed three vehicles at the residence. At the reception, Kim Chul-Su, Minister of Trade, Industry, and Energy acknowledged the severe trade imbalance in automobiles, and pledged that the Government of Korea will not discriminate against Korean owners of foreign cars.

In the wake of Card's visit and the minishow of autos, the Government of Korea took several steps designed to ease entry for foreign automobiles in Korea. As part of a 1989 agreement, the import duty applied to automobiles had been reduced in stages from 25 percent to 10 percent. In June 1994, Korea announced that it would lower the tariff to 8 percent. It also authorized U.S. companies to advertize on prime time television, opened the automobile retail distribution sector to foreign investors, and relaxed approval and inspection procedures for imported vehicles. In addition, the government reiterated its insistence that owners of foreign cars will not be

subject to tax audits or other discriminatory treatment. The Korean authorities also permitted establishment of car-financing companies and increased space allowances for automobile showrooms.

The Korean auto market is the second-largest is Asia after that of Japan, and it has been estimated to be the fastest growing auto market in the world. Korean industry forecasts 1994 sales at about 1.1 million units, up by 12.1 percent over sales of 1993. The market, however, is effectively closed to imports. The quantity of U.S. vehicles sold in 1993 in Korea, 1,463 units, accounted for about one-tenth of 1 percent of the Korean auto market. Imports of automobiles from all sources accounted for two-tenths of 1 percent.

Current U.S. marketing efforts in Korea are concentrating on large autos (2-liter engines and above). The Korean Government is projecting that automobile imports into Korea will rise from the current level of about 2,000 units per year to 4,000 in 1995, 31,000 in 1998, and 82,000 in 2001. Sales of large automobiles are expected to reach 16,000 units this year. However, even if U.S. automakers captured this entire segment of the market, they would still account for only 1.5 percent of the passenger vehicle market in Korea.

A small but fast-growing segment of the market with potential for U.S. exports is sport-utility vehicles, sales of which are projected to reach 90,000 units in 1994, although imports are expected to account for less than 700 units. In order to develop a significant market share in Korea, however, U.S. officials point out that U.S. automakers will have to export smaller cars to Korea and develop marketing and other cooperative relationships with Korean firms.

Two major U.S. automakers already have significant investment in Korea. Ford and General Motors currently operate joint ventures with Korean partners in auto parts production. Ford's investment with Kia Motors and other auto parts producers is approximately $137 million. General Motors has invested about $48 million in its joint venture with Daewoo and other parts producers. In 1993, exports of auto parts to Korea reached $200 million and imports from Korea exceeded $145 million.

STATISTICAL TABLES

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Industrial production, by selected countries and by specified periods, Jan. 1991-August 1994
(Total industrial production, 1985=100)

Country	1991	1992	1993	1993 III	1993 IV	1993 Dec.	1994 I	1994 II	1994 Mar.	1994 Apr.	1994 May	1994 Jun.	1994 Jul.	1994 Aug.
United States[1]	104.2	104.3	109.2	111.1	112.9	109.0	115.1	116.7	115.7	116.0	116.6	117.3	117.7	118.5
Japan	127.7	120.4	115.3	115.8	114.7	111.6	112.6	(2)	125.5	114.8	107.6	(2)	(2)	(2)
Canada[3]	113.8	114.9	118.0	121.2	119.6	115.5	117.0	(2)	120.3	121.5	(2)	(2)	(2)	(2)
Germany[4]	100.0	98.1	91.5	88.8	95.1	89.7	92.6	(2)	100.2	94.0	92.8	(2)	(2)	(2)
United Kingdom	109.0	108.6	111.1	105.1	116.7	110.8	118.7	(2)	124.1	113.9	113.0	(2)	(2)	(2)
France	114.2	112.9	108.6	97.3	111.5	110.0	(2)	(2)	116.3	116.9	113.7	(2)	(2)	(2)
Italy	116.8	115.3	112.8	96.0	116.3	105.4	119.2	(2)	123.3	125.7	125.0	(2)	(2)	(2)

1 1987=100
2 Not available.
3 Real domestic product.
4 1991=100

Source: *Main Economic Indicators;* Organization for Economic Cooperation and Development, August 1994, *Federal Reserve Statistical Release;* September 16 1994.

Consumer prices, by selected countries and by specified periods, Jan. 1991-July 1994
(Percentage change from same period of previous year)

Country	1991	1992	1993	1993 II	1993 III	1993 IV	1993 Dec.	1994 I	1994 II	1994 Feb.	1994 Mar.	1994 Apr.	1994 May	1994 Jun.	1994 Jul.
United States	4.2	3.0	3.0	3.1	2.7	2.7	2.7	2.5	2.4	2.5	2.5	2.4	2.3	2.5	2.8
Japan	3.3	1.6	1.3	0.9	1.8	1.1	1.0	1.2	0.7	1.1	1.3	0.8	0.8	0.6	(1)
Canada	5.6	1.5	1.8	1.7	1.7	1.8	1.7	0.6	0.0	0.2	0.2	0.2	-0.2	0.0	0.2
Germany	3.5	4.0	4.2	4.2	4.2	3.7	3.7	3.3	3.0	3.3	3.2	3.1	3.0	3.0	(1)
United Kingdom	5.9	3.7	1.6	1.3	1.6	1.6	1.9	2.4	2.6	2.4	2.3	2.6	2.6	2.6	2.3
France	3.2	2.4	2.0	2.0	2.2	2.1	2.1	1.7	1.7	1.8	1.5	1.7	1.7	1.8	1.6
Italy	6.4	5.1	4.4	4.5	4.5	4.4	4.3	(1)	(1)	4.4	4.3	4.1	4.0	(1)	(1)

1 Not available.

Source: *Consumer Price Indexes, Nine Countries*, U.S. Department of Labor, September 1994.

Unemployment rates, (civilian labor force basis)[1] by selected countries and by specified periods, Jan. 1991-July 1994

Country	1991	1992	1993	1993 III	1993 IV	1993 Dec.	1994 I	1994 II	1994 Mar.	1994 Apr.	1994 May	1994 Jun.	1994 Jul.
United States	6.7	7.4	6.8	6.7	6.5	6.4	6.6	6.2	6.5	6.4	6.0	6.0	6.1
Japan	2.1	2.2	2.5	2.6	2.8	2.9	2.8	2.8	2.9	2.8	2.8	2.9	(2)
Canada	10.3	11.3	11.2	11.4	11.1	11.2	11.0	10.7	10.6	11.0	10.7	10.3	10.2
Germany[3]	4.4	4.7	5.9	6.1	6.4	6.5	6.4	6.6	6.5	6.6	6.6	6.6	(2)
United Kingdom	8.9	10.0	10.4	10.5	10.1	10.0	10.0	9.6	9.8	9.7	9.6	9.6	9.6
France	9.8	10.2	11.3	11.3	11.7	11.7	12.3	(2)	12.4	12.4	12.4	12.4	(2)
Italy[4]	6.9	7.3	9.4	10.6	(2)	(5)	(5)	11.9	(5)	(5)	(5)	(5)	(5)

1 Seasonally adjusted; rates of foreign countries adjusted to be comparable with the U.S. rate.
2 Not available.
3 Formerly West Germany.
4 Many Italians reported as unemployed did not actively seek work in the past 30 days, and they have been excluded for comparability with U.S. concepts. Inclusion of such persons would increase the unemployment rate to 11-12 percent in 1989-1990.
5 Italian unemployment surveys are conducted only once a quarter, in the first month of the quarter.

Source: *Unemployment Rates in Nine Countries*, U.S. Department of Labor, September 1994.

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Money-market interest rates,[1] by selected countries and by specified periods, Jan. 1991-August 94
(Percentage, annual rates)

Country	1991	1992	1993	1993 III	IV	Dec.	I	1994 II	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.
United States	5.9	3.7	3.2	3.1	3.3	3.4	3.4	4.3	3.6	3.7	4.0	4.5	4.5	4.7	4.8
Japan	7.3	4.4	2.9	2.9	2.2	2.0	2.2	2.1	2.2	2.2	2.2	2.1	2.1	2.1	([2])
Canada	9.0	6.7	5.1	4.6	4.3	4.0	4.0	5.7	3.8	4.4	4.4	6.3	6.5	6.2	([2])
Germany	9.1	9.4	7.1	6.6	6.2	5.9	5.7	5.1	5.7	5.7	5.4	5.0	4.9	4.8	([2])
United Kingdom	11.5	9.5	5.8	5.8	5.4	5.2	5.2	5.1	5.1	5.1	5.1	5.1	5.1	5.1	([2])
France	9.5	10.1	8.3	7.4	6.5	6.3	6.1	5.5	6.1	6.1	5.8	5.5	5.4	5.5	([2])
Italy	12.0	13.9	10.0	9.2	8.7	8.5	8.3	7.9	8.4	8.3	8.0	7.7	8.0	8.3	([2])

[1] 90-day certificate of deposit.
[2] Not available.

Source: *Federal Reserve Statistical Release*, September 6, 1994 *Federal Reserve Bulletin*, September 1994.

Effective exchange rates of the U.S. dollar, by specified periods, Jan. 1991-August 1994
(Percentage change from previous period)

Item	1991	1992	1993	1993 IV	1994 I	II	Mar.	Apr.	May	Jun.	Jul.	Aug.
Unadjusted:												
Index[1]	98.5	97.0	100.1	101.2	101.6	100.0	100.9	100.9	100.0	99.1	96.7	97.1
Percentage change	-1.5	-1.5	3.1	1.6	.4	-1.6	-.5	0	-.9	-.9	-2.4	.4
Adjusted: Index[1]	101.1	100.9	104.2	104.1	104.7	103.5	103.9	104.2	103.2	102.5	100.0	100.7
Percentage change	1.0	-.1	3.3	.4	.6	-1.2	-.6	.3	-.9	-.6	-2.5	.7

[1] 1990 average=100.

Note.—The foreign-currency value of the U.S. dollar is a trade-weighted average in terms of the currencies of 18 other major nations. The inflation-adjusted measure shows the change in the dollar's value after adjusting for the inflation rates in the United States and in other nations; thus, a decline in this measure suggests an increase in U.S. price competitiveness.

Source: Morgan Guaranty Trust Co. of New York, September 1994.

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Trade balances, by selected countries and by specified periods, Jan. 1991-July 1994
(In billions of U.S. dollars, Exports less Imports (f.o.b - c.i.f), at an annual rate)

Country	1991	1992	1993	1993 IV	1993 Dec.	1994 I	1994 II	1994 Apr.	1994 May	1994 Jun.	1994 Jul.
United States[1]	-65.4	-84.5	-115.7	-111.7	-103.9	-129.1	-152.4	-144.5	-154.6	-156.3	175.1
Japan	77.6	106.4	120.3	41.7	44.7	42.4	(2)	(2)	(2)	(2)	(2)
Canada[3]	9.0	12.1	13.3	3.8	3.4	4.2	(2)	(2)	(2)	(2)	(2)
Germany	13.2	21.0	35.8	17.9	47.0	13.1	(2)	(2)	(2)	(2)	(2)
United Kingdom	-24.8	-30.8	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
France[3]	-5.2	5.8	15.8	6.4	27.1	3.6	(2)	(2)	(2)	(2)	(2)
Italy	-13.2	-6.6	20.6	7.5	14.8	(2)	(2)	(2)	(2)	(2)	(2)

[1] Figures are adjusted to reflect change in U.S. Department of Commerce reporting of imports at customs value, seasonally adjusted, rather than c.i.f.value.
[2] Not available.
[3] Imports are f.o.b.

Source: *Advance Report on U.S. Merchandise Trade*, U.S. Department of Commerce, September 20, 1994; *Main Economic Indicators;* Organization for Economic Cooperation and Development, July 1994.

U.S. trade balance, [1] by major commodity categories and by specified periods, Jan. 1991-July 1994
(In billions of dollars)

Country	1991	1992	1993	1993 IV	1994 I	1994 II	1994 Mar.	1994 Apr.	1994 May	1994 Jun.	1994 Jul.
Commodity categories:											
Agricultur	16.2	18.6	17.8	5.6	4.4	3.6	1.4	1.2	1.3	1.1	1.2
Petroleum and selected product— (unadjusted)	-42.3	-43.9	-45.7	-10.7	-9.6	-11.9	-3.5	-3.6	-3.8	-4.5	-4.8
Manufactured goods	-67.2	-86.7	-115.3	-32.8	-29.1	-33.8	-9.5	-9.7	-10.8	-13.3	-14.2
Selected countries:											
Western Europe	16.1	6.2	-1.4	-1.2	-.1	-2.3	.3	-.1	-1.4	-1.8	-2.3
Canada[2]	-6.0	-7.9	-10.2	-2.8	-2.7	-3.0	-.6	-.9	-.8	-1.3	-1.3
Japan	-43.4	-49.4	-59.9	-17.1	-15.0	-15.4	-5.8	-5.5	-4.4	-5.5	-5.7
OPEC (unadjusted)	-13.8	-11.2	-11.6	-1.6	-1.6	-3.7	-.7	-1.1	-1.0	-1.6	-1.7
Unit value of U.S.imports of petroleum and selected products (unadjusted)	$17.42	$16.80	$15.13	$13.52	$11.80	$13.98	$11.78	$12.77	$14.04	$15.14	$16.06

[1] Exports, f.a.s. value, unadjusted. Imports, customs value, unadjusted.
[2] Beginning with 1989, figures include previously undocumented exports to Canada.

Source: *Advance Report on U.S. Merchandise Trade*, U.S. Department of Commerce, September 20, 1994.

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